(21)

No. 88-1400

In the Supreme Court
of the
United States

OCTOBER TERM, 1989

FRANCHISE TAX BOARD OF THE STATE OF CALIFORNIA; LEONARD WILSON, Individually and as District Manager, Chicago Office of the Franchise Tax Board of the State of California; and B.M. RARANG, Individually and as Auditor, Chicago Office of the Franchise Tax Board of the State of California,
Petitioners,

vs.

ALCAN ALUMINIUM LIMITED and IMPERIAL CHEMICAL INDUSTRIES PLC,
Respondents.

On Writ of Certiorari to the United States Court of Appeals for the Seventh Circuit

REPLY BRIEF OF PETITIONERS

JOHN K. VAN DE KAMP
Attorney General of the
State of California
TIMOTHY G. LADDISH
Assistant Attorney General
(Counsel of Record)
350 McAllister St., Rm. 6000
San Francisco, CA 94102-36000
(415) 557-0792
Attorneys for Petitioners

Of Counsel:

PATRICIA STRELOFF, ESQ.
3436 Springhill Road
Lafayette, CA 94549

BOWNE OF SAN FRANCISCO, INC. • 190 NINTH ST. • S.F., CA 94103 • (415) 864-2300

34 pp

TABLE OF CONTENTS

Page

Table of Authorities iii
Introduction and Summary of Argument 1
Argument 3

I

The Taxes in Question Are Being Assessed Against the Domestic Subsidiaries Under a Method of Accounting Whose Basic Fairness is Beyond Dispute 3

A. The actual taxpayers are the domestic subsidiaries, not their parent companies or the unitary businesses in which they participate 3

B. The basic fairness of California's unitary business/formula apportionment method of accounting is settled 7

II

The Constitutionality of the Unitary Business/Formula Apportionment Method of Accounting as Applied to the Domestic Subsidiary of a Foreign Parent Should Be Litigated by the Domestic Subsidiary, Which is the Party Directly Injured by the Actions of the Taxing Authorities 10

A. Stockholder standing is resolved by determining whether distinct legal rights exist, not by determining the merits 10

B. All of the alleged injuries to the parent companies result from actions taken against the subsidiaries; thus, without more, the injuries are clearly "derivative" 12

C. The alleged burden on the parent companies' decision-making is not a cognizable injury, whether it be considered direct or indirect 15

D. The parent companies do not hold legal rights distinct from those of their domestic subsidiaries.......... 18

Page

III

Even If the Parent Companies Can Be Viewed as Suffering Direct Injuries as a Result of California's Method of Taxing Their Domestic Subsidiaries, the Parent Companies Should Be Required to Pursue Their Constitutional Objections Through the State Remedies Effectively Available to Them 21

A. Respondents and their amici have not advanced any plausible basis for their assertion that the available state remedies are inadequate 21

B. The entertainment of such actions by the federal courts would frustrate the policies underlying the Tax Injunction Act 25

Conclusion 29

TABLE OF AUTHORITIES

Cases

Page

Alcan Aluminum Ltd. v. Franchise Tax Board, 558 F. Supp. 624 (S.D.N.Y. 1983), aff'd mem., 742 F. 2d 1430 (2d Cir. 1983), cert. den., 464 U.S. 1041 (1984) 23

American Power & Light Co. v. S.E.C., 325 U.S. 385 (1945) 10

Asarco, Inc. v. Kadish, ____ U.S. ____, 109 S. Ct. 2037 (1989) 11, 14

Bacchus Imports, Ltd. v. Dias, 468 U.S. 263 (1984) 6

Barclays Bank International Ltd. v. Franchise Tax Board, Cal. Ct. App., 3rd Dist. (No. C003388) 17, 23

Bass, Etc., Ltd. v. Tax Comm., 266 U.S. 271 (1924) 7, 16

Bob Jones University v. Simon, 416 U.S. 725 (1974) 25

Butler Bros. v. McColgan, 315 U.S. 501 (1942) 7

Chase Brass & Copper Co. v. Franchise Tax Board, 10 Cal. App. 3d 496, 95 Cal. Rptr. 805 (1970), cert. den., 400 U.S. 961 (1970) 20

Complete Auto Transit, Inc. v. Brady, 430 U.S. 274 (1977) 22

Container Corp. v. Franchise Tax Board, 463 U.S. 159 (1983) .... *passim*

Cowin v. Bresler, 741 F. 2d 410 (D.C. Cir. 1984) 10

Edison California Stores v. McColgan, 30 Cal. 2d 472, 183 P. 2d 16 (1947) 4, 16, 20

EMI Ltd. v. Bennett, 739 F. 2d 994 (9th Cir. 1984), cert. den., 469 U.S. 1073 (1984) 12

Exxon Corp. v. Governor of Maryland, 437 U.S. 117 (1978) 20

Exxon Corp. v. Wisconsin Department of Revenue, 447 U.S. 207 (1980) 7

Japan Line, Ltd. v. Los Angeles County, 441 U.S. 434 (1979) 9, 22

Mobil Oil Corp. v. Commissioner of Taxes, 445 U.S. 425 (1980) 7

Moorman Mfg. Co. v. Bair, 437 U.S. 267 (1978) 7

Pacific Gas & Electric Co. v. State Bd. of Equalization, 27 Cal. 3d 277, 165 Cal. Rptr. 122, 611 P. 2d 463 (1980) . 26

Pennzoil Co. v. Texaco, Inc., 481 U.S. 1 (1987) 24

Table of Authorities

Cases

Page

Schenley Corp. v. United States, 326 U.S. 432 (1946) . . . 11, 25
South Carolina v. Regan, 465 U.S. 367 (1984) 24, 25
Underwood T'Writer Co. v. Chamberlain, 254 U.S. 113 (1920) 7
Wardair Canada v. Florida Dept. of Revenue, 477 U.S. 1 (1986) 27
Warth v. Seldin, 422 U.S. 490 (1975) 11

United States Constitution

U.S. Const., Art. I, § 8, Cl. 3 (Foreign Commerce Clause) . . . . *passim*
U.S. Const., Art. III, § 2 (Federal Judicial Clauses) 11, 14

California Constitution

Cal. Const., Art. XIII, § 32 26

Statutes

26 U.S.C. § 482 4
26 U.S.C. § 7421(a) (Anti-Injunction Act) 24
28 U.S.C. § 1341 (Tax Injunction Act) . . . . *passim*
Cal. Rev. & Tax. Code:
§ 25101 4
§ 25102 4
§ 25110 et seq 17
Uniform Division of Income for Tax Purposes Act 5

Other Authorities

Article V, § 1, Treaty of Friendship, Commerce and Navigation between the United States of America and The Kingdom of The Netherlands, March 27, 1956 28
Forbes (April 15, 1963; August 1, 1967; February 15, 1969) 9

No. 88-1400

In the Supreme Court of the United States

October Term, 1989

Franchise Tax Board of the State of California; Leonard Wilson, Individually and as District Manager, Chicago Office of the Franchise Tax Board of the State of California; and B.M. Rarang, Individually and as Auditor, Chicago Office of the Franchise Tax Board of the State of California,
Petitioners,

vs.

Alcan Aluminium Limited and Imperial Chemical Industries PLC,
Respondents.

On Writ of Certiorari to the United States Court of Appeals for the Seventh Circuit

REPLY BRIEF OF PETITIONERS

INTRODUCTION AND SUMMARY OF ARGUMENT

Respondents in this matter, both of which are corporations organized and doing business outside the United States, are attempting to litigate an issue left open in *Container Corp. v. Franchise Tax Board*, 463 U.S. 159 (1983): whether it is constitutionally permissible for a state to use the unitary business/formula apportionment method of accounting to calculate the taxable income of U.S. subsidiaries of foreign parent companies. Although the parent companies are not the taxpayers di-

rectly concerned, they claim that they have standing in the federal courts to litigate this constitutional issue and should not be impeded by either the Tax Injunction Act or its underlying principle of comity. The Franchise Tax Board of the State of California contends that the taxpayer-subsidiaries are the only proper parties to challenge the constitutionality of the method by which they have been taxed. The Board further contends that, even if it is assumed or determined that the parent companies also have standing to make such a challenge, they should not be permitted to resort to the federal courts due to the total control they exercise over their subsidiaries' pursuit of alternative state remedies.

The parent companies' claim of standing essentially rests on two arguments: (1) that *only* the parent companies are in a position to object to California's method of taxation on Foreign Commerce Clause grounds, and (2) that, in any case, California's method of taxation imposes burdens on the parent companies that are different from those imposed on the corporate taxpayers. The first argument is inconsistent with the parent companies' basic premise that the Foreign Commerce Clause is applicable here because their U.S. subsidiaries constitute "instrumentalities of foreign commerce." If that premise is correct, the subsidiaries, as the "instrumentalities of foreign commerce" which are required to pay the assertedly illegal taxes, clearly have standing to object to California's method of taxation on Foreign Commerce Clause grounds. The second argument is faulty because it assumes, without further analysis, that a corporate stockholder is entitled to bring an individual action whenever the alleged injuries to the stockholder differ from those suffered by the corporation. This is an oversimplified interpretation of the stockholder standing rule. A corporate stockholder who is injured by actions taken against the corporation may complain of such actions only when he has distinct legal rights or interests at stake. That factor—the holding of distinct legal rights or interests—is the necessary ingredient missing in the present case.

Furthermore, even if the parent companies hold distinct legal rights and thus are directly affected by the taxes imposed on their subsidiaries, they should be required to pursue the state remedies

effectively available to them. The parent companies have total control over their U.S. subsidiaries, and hence total control over the pursuit of state remedies by the actual taxpayers. The argument that such remedies are inadequate because there is no assurance that a state court would address all of the Foreign Commerce Clause issues is ill-founded. This Court held in *Container* that, when a state tax case involves a unitary business that is international in scope, as distinguished from a unitary business that operates only in interstate commerce, the case must be subjected to the additional scrutiny required by the Foreign Commerce Clause. 463 U.S., at 185. It cannot be presumed that a state court will decline to follow this mandate.

ARGUMENT

I

THE TAXES IN QUESTION ARE BEING ASSESSED AGAINST THE DOMESTIC SUBSIDIARIES UNDER A METHOD OF ACCOUNTING WHOSE BASIC FAIRNESS IS BEYOND DISPUTE

A. The actual taxpayers are the domestic subsidiaries, not their parent companies or the unitary businesses in which they participate

In both of the actions before the Court, it is a *stipulated fact* that the taxes in question have been assessed only against the respondents' domestic subsidiaries. JA 53, 99. This undisputed fact obviously raises a formidable obstacle to respondents' claims that they have standing to litigate the constitutionality of the tax assessments and must be afforded a direct remedy for doing so. Undaunted, respondents insist that the obstacle in their path is only a mirage. Both argue throughout their briefs that the stipulated identity of the taxpayers is meaningless, and that the "actual" taxpayers are either (1) the parent companies themselves, or (2) the unitary enterprises as a whole, for which the respective parent companies are the proper spokesmen.[1]

---

[1] Alcan goes so far as to assert that the "real party in interest" is the parent company, and therefore whether its subsidiary could challenge

The use of the unitary business/formula apportionment method of accounting as applied to a domestic company with foreign subsidiaries was upheld by this Court in *Container Corp. v. Franchise Tax Board*, 463 U.S. 159 (1983). During the course of its opinion, the Court observed that "Although California 'counts' income arguably attributable to foreign corporations in calculating the taxable income of that domestic corporation, the legal incidence of the tax falls on the domestic corporation." 463 U.S., at 195. That, of course, is true here as well. The legal incidence of the tax falls on the domestic corporations which are the entities doing business in California and are the entities against which the taxes have been assessed. Thus no amount of hocus-pocus can disguise the fact that it is the domestic subsidiaries which are the California taxpayers.[2]

Respondents and their amici nevertheless try their hand at magically transforming the domestic subsidiaries into nontaxpayers or, at best, only "nominal" taxpayers. Imperial, for example, asserts that California law classifies the entire unitary enterprise as the "taxpayer" for assessment purposes.[3] Imperial is

---

the tax assessments in the state courts "is in serious doubt." Brief for Respondent Alcan Aluminium Limited ("Alcan Brf."), at 47, n. 24. The assertion is patently absurd.

[2] The Court said in *Container* that, in analyzing the constitutional claims based on the Foreign Commerce Clause, "the fact that the legal incidence of a tax falls on a corporation whose formal corporate domicile is domestic might be less significant in the case of a domestic corporation that was owned by foreign interests." 463 U.S., at 195, n. 32. In other words, the foreign parentage of a domestic corporation may bear on the merits of the constitutional claims. However, it has nothing to do with the taxpayer status of that corporation.

[3] In support of this proposition, at least two of the amici refer to section 25102 of the California Revenue and Taxation Code. However, the authority for requiring a combined report in the case of two or more corporations engaged in a unitary business is derived from section *25101* of the Code, not section 25102. See, e.g., *Edison California Stores v. McColgan*, 30 Cal. 2d 472, 480, 183 P. 2d 16 (1947) (construing predecessors of sections 25101 and 25102). Section 25102, which contains language similar to that of section 482 of the Internal Revenue

just plain wrong. As previously explained, California uses the three-factor apportionment formula set forth in the Uniform Division of Income for Tax Purposes Act ("UDITPA"). This formula consists of three fractions. The numerators of the fractions reflect the property, payroll and sales of the unitary business within the taxing state, while the denominators reflect the property, payroll and sales of the unitary business everywhere. In describing what goes into the denominator of each fraction, UDITPA uses the term "taxpayer" to refer to the entire unitary business encompassed within a state's apportionment provisions, e.g., " . . . the denominator of [the sales factor] is the total sales of the taxpayer everywhere during the income year." California applies the apportionment provisions of UDITPA not only when a unitary business is conducted by a single corporation, but also when such a business is conducted in a multi-corporate form. Consequently, under California law, the term "taxpayer" in the UDITPA provisions describing the denominators of the fractions necessarily refers to all components of the unitary business if more than one corporation is involved. Imperial is claiming, in short, that the unitary business which it heads is the "taxpayer" for assessment purposes simply because the denominators of the fractions reflect the total property, payroll and sales of that unitary business. On the contrary, the taxpayers for assessment purposes here are the corporations whose California factors go into the *numerators* of the fractions.

Alcan similarly claims that its subsidiary is not the "actual" taxpayer because California admittedly taxes a portion of the unitary income. According to Alcan, this means that the California tax is imposed on the income of the unitary business, not on the income earned by the subsidiary in California. The argument has several obvious flaws. First, it disregards the fact that this Court repeatedly has upheld the unitary business/formula appor-

---

Code, authorizes the board to require a combined report or make other adjustments in reported income or deductions when necessary "to reflect the proper income" of "two or more persons . . . owned or controlled directly or indirectly by the same interests." It does not pertain to the combined report required in a unitary situation and makes no reference at all to the California "taxpayer."

tionment method of accounting as a fair and proper method of determining the amount of unitary income attributable to the *in-state* activities of a component of a unitary business. See, *infra*, at 7. Second, the argument assumes that it is possible to pinpoint the geographic source of particular items of unitary income—a proposition rejected not only in *Container*, but in every other case in which this Court has upheld the use of formula apportionment as applied to a unitary business. Third, and finally, the argument offers no explanation for treating the entire unitary business as the "actual" taxpayer merely because an *apportioned share* of the unitary income earned by the business as a whole is attributed to a jurisdiction in which one component of the unitary enterprise does business.

Respondents and their amici further attempt to discredit the taxpayer status of the domestic subsidiaries by arguing that the California tax is imposed on income earned by other components of the unitary business outside the state. This argument is subject to flaws already noted above. In addition, the results reached by the use of formula apportionment cannot be impeached simply upon a showing that they differ from the results reached under the separate accounting/arm's length method of accounting. See, e.g., *Container, supra*, at 181-182. It would be contrary to the logic of the *Container* decision to conclude that respondents may impeach the taxpayer status of their subsidiaries by asserting that, according to the separate accounting/arm's length method of accounting, California is taxing the income of the parents and their subsidiaries doing business in foreign countries.

It is also argued that respondents should be elevated to the role of "taxpayers" because the economic burden of the California taxes falls on the parent companies or the unitary businesses as a whole. But even assuming that what is said about the economic burden of the taxes is true, it by no means follows that either the parent companies or the unitary businesses as a whole are the "actual" taxpayers. As *Bacchus Imports, Ltd. v. Dias*, 468 U.S. 263 (1984) demonstrates, the taxpayer for standing purposes is the party against whom the taxes are assessed; this status is not lost merely because the economic burden is ultimately borne by a third party.

B. The basic fairness of California's unitary business/formula apportionment method of accounting is settled

A number of arguments made by respondents and their amici with respect to the parent companies' standing in this matter constitute an attack on the unitary concept and the use of formula apportionment generally. Such an attack on the unitary approach comes too late.

Nearly 70 years ago, in *Underwood T'Writer Co. v. Chamberlain*, 254 U.S. 113 (1920), this Court approved the use of formula apportionment to determine the locally taxable income of a corporation engaged in a multistate unitary business, saying that in such an instance the taxing state is "faced with the impossibility of allocating specifically the profits earned by the processes conducted within its borders." *Id.*, at 121. Since then, the Court time and again has upheld formula apportionment as a reasonable and valid means of determining the amount of income of a unitary business fairly attributable to sources within a particular taxing jurisdiction—including income derived from such a business conducted on a multinational scale. See, e.g., *Bass, Etc., Ltd. v. Tax Comm.*, 266 U.S. 271 (1924); *Butler Bros. v. McColgan*, 315 U.S. 501 (1942); *Moorman Mfg. Co. v. Bair*, 437 U.S. 267 (1978); *Mobil Oil Corp. v. Commissioner of Taxes*, 445 U.S. 425 (1980); *Exxon Corp. v. Wisconsin Department of Revenue*, 447 U.S. 207 (1980); *Container Corp. v. Franchise Tax Board*, 463 U.S. 159 (1983).

In particular, this Court said in *Container* that California's application of the unitary business/formula apportionment method of accounting to a domestic company with foreign subsidiaries was a "proper and fair method of taxation;" that the three-factor formula employed by California has become "something of a benchmark against which other apportionment formulas are judged" because "payroll, property, and sales appear in combination to reflect a very large share of the activities by which value is generated;" that the separate accounting/arm's length method of taxation "often ignores or captures inadequately the many subtle and largely unquantifiable transfers of value that take place among the components of a single enterprise;" and that proferred evidence of distortion under the unitary method, as allegedly

shown by separate accounting figures, "does not come close to impeaching the basic rational behind the three-factor formula" because such evidence is "based on precisely the sort of formal geographic accounting whose theoretical weaknesses justify resort to formula apportionment in the first place." 463 U.S., at 184, 170, 183, 164, 181-182.

Although obstensibly directed to the standing question, a number of arguments made by respondents and their amici dispute these findings. One amicus declares that California's three-factor formula, which the Court in *Container* termed a "benchmark," was chosen by California to "ensure[ ] income distortion in favor of its own economy." Brief of the Union of Industrial and Employers' Confederations of Europe, et al. ("Union Brf."), at 9. Another amicus, taking issue with the *Container* description of the shortcomings of the separate accounting/arm's length method of taxation, states that "in no case is income apportioned on an arbitrary basis under AL/SA." Brief of the Government of the United Kingdom, at 4. Still another amicus (in a convoluted effort to restrict its argument to the question presented for review) contends that "The application of a unitary tax 'upstream' to a foreign parent presents special problems not previously addressed by the Court in its review of 'downstream' applications of a unitary tax, and those problems further support a finding of standing." Brief Amicus Curiae of Shell Petroleum N.V. ("Shell Brf."), at 19. The theory of that amicus is that values derived from the conduct of a unitary business, such as economies of scale, flow only "downstream." *Id.*, at 21. This is not true; values can flow "upstream" as well as down. Alcan's U.S. operations provide a case in point. In interviews granted to Forbes magazine in the 1960's, Nathanael Davis, president of Alcan Aluminium Ltd., explained that the company had established "captive fabricating outlets" in the United States and elsewhere to provide guaranteed markets for its smelted aluminum, the idea being that the demands for smelted aluminum by such outlets

would help absorb the overhead costs of Alcan's smelters in Canada.[4]

In sum, the protestations of respondents and their amici must be kept in perspective. This Court determined in *Container* that the apportionment formula used by California meets the standard of fairness "under *both* the Due Process and Commerce Clauses." *Container, supra*, at 169; emphasis added. It also held in *Container* that California's use of the apportionment method in calculating the locally taxable income of a domestic company with foreign subsidiaries withstood the additional scrutiny required when foreign commerce is involved.[5] The question left

[4] See *Aluminium Limited: Modifying the Grand Design*, Forbes (April 15, 1963), at pp. 20-24; *Counterattack*, Forbes (August 1, 1967), at pp. 24-25; *Defensive Standoff*, Forbes (February 15, 1969), at p. 59.

[5] Imperial suggests that the *Container* decision established the proposition that *any* state tax imposed on an instrumentality of commerce owned by a foreign corporation is constitutionally invalid if it presents a risk of double taxation. See Brief for Respondent Imperial Chemical Industries PLC ("Imperial Brf."), at 8. *Container*, first of all, did not even involve a tax imposed on a foreign-owned instrumentality of commerce. More importantly, the *Container* court distinguished *Japan Line, Ltd. v. Los Angeles County*, 441 U.S. 434 (1979) not only on the two grounds discussed by Imperial, see Imperial Brf., at 9, but also on a third ground: that *Japan Line* involved a tax on property, while *Container* involved a tax on income. 463 U.S., at 187-188. With respect to the issue of double taxation, the Court stated that if language used in *Japan Line* were to be interpreted as establishing "an absolute prohibition on state-induced double taxation in the international context, then our analysis here would be at an end." *Id.*, at 189. The Court continued:

> "But in fact such an absolute rule is no more appropriate here than it was in *Japan Line* itself, where we relied on much more than the mere fact of double taxation to strike down the state tax at issue. Although double taxation in the foreign commerce context deserves to receive close scrutiny, that scrutiny *must take into account the context in which the double taxation takes place and the alternatives reasonably available to the taxing State.*" *Ibid.*; emphasis added.

Alcan says that the distinction which the Court drew in *Container* between a property tax and a tax on income "represent[s] a complete

undecided was whether, despite its basic fairness, the unitary business/formula apportionment method of accounting, due to Foreign Commerce Clause considerations, is constitutionally impermissible when applied either to foreign corporations or to domestic corporations with foreign parents. *Id.*, at 189, n. 26.

II

THE CONSTITUTIONALITY OF THE UNITARY BUSINESS/FORMULA APPORTIONMENT METHOD OF ACCOUNTING AS APPLIED TO THE DOMESTIC SUBSIDIARY OF A FOREIGN PARENT SHOULD BE LITIGATED BY THE DOMESTIC SUBSIDIARY, WHICH IS THE PARTY DIRECTLY INJURED BY THE ACTIONS OF THE TAXING AUTHORITIES

A. Stockholder standing is resolved by determining whether distinct legal rights exist, not by determining the merits

The central theme of the arguments presented in support of the parent companies' standing in this matter is that California's application of the unitary business/formula apportionment method of accounting to their domestic subsidiaries results in the imposition of burdens on the parent companies which are different from the burdens imposed on the subsidiary-taxpayers. This is not really the point. Under the particular rule applicable to the standing of corporate stockholders, a stockholder may complain of actions taken against the corporation only when he holds a legal right or interest which is distinct from any legal right held by the corporation. Thus, a stockholder may challenge actions against a corporation when (1) he is injured in a capacity other than that of a stockholder, as where a special duty is owed to the stockholder personally, or (2) he is injured in his capacity as a stockholder, but the corporation itself is not injured, in which case only the stockholder's rights or interests are at stake. *Cowin v. Bresler*, 741 F. 2d 410, 415 (D.C. Cir. 1984); cf., *American Power & Light Co. v. S.E.C.*, 325 U.S. 385, 388-391 (1945). It is clear in the present case that the subsidiaries themselves are directly injured by the

misunderstanding of the nature of property taxation." Alcan Brf., at 34. The Board will leave it to Alcan to carry on *that* debate with the Court.

actions of the Board which are claimed to injure the parent companies. Accordingly, the parent companies may challenge these actions only if they are injured in a capacity other than as corporate stockholders. See, e.g. *Schenley Corp. v. United States*, 326 U.S. 432, 435 (1946) (parent company asserting only its stockholder's derivative rights "is adequately represented for purposes of suit by the subsidiary whose conduct of the litigation it controls"). This, in turn, depends on whether the parent companies hold legal rights distinct from those held by their subsidiaries.[6]

Alcan's assertion that "it is simply impossible to resolve the standing issue without resolving the fundamental constitutional issue," Alcan Brf., at 17, is clearly incorrect. As this Court reaffirmed just last term, standing "'in no way depends on the merits of the [claim].'" *Asarco, Inc. v. Kadish*, ____ U.S. ____, 109 S. Ct. 2037, 2049 (1989) (quoting *Warth v. Seldin*, 422 U.S. 490, 500 (1975)); brackets in original. Thus, whether the parent companies have standing does not depend on the legality of California's method of taxation; their standing goes to the question of whether they have legal rights distinct from those of their subsidiaries. To put it a different way: the parent companies' subsidiaries are directly injured by the assessments of additional taxes, whether or not those assessments are constitutionally infirm. Conversely, even if it is assumed that California's method of taxation violates the Foreign Commerce Clause, this does not

[6] A stockholder bringing suit in federal court to challenge actions against the corporation in which he holds an interest must, of course, also satisfy the "injury in fact" requirement under Article III. The Court of Appeals held in this case that the parent companies' "ownership interests in their domestic subsidiaries alone" was a sufficient basis for concluding that the parent companies suffer "injury in fact" as a result of California's method of taxing their domestic subsidiaries. Pet. App., at A5-6. Assuming this is correct, respondents must still deal with the long-established stockholder standing rule, which is analogous to, but a more particularized version of, the prudential standing rule that "the plaintiff generally must assert his own legal rights and interests, and cannot rest his claim to relief on the legal rights of third parties." *Warth v. Seldin*, 422 U.S. 490, 499 (1975).

establish a direct injury to the parent companies for standing purposes. It would therefore be unnecessary (and clearly improper) for a court to resolve the merits of the constitutional claims under the guise of determining whether the parent companies have standing to raise the constitutional issues in the first place. Alcan has confused the direct injury which must be shown for standing purposes with the "ultimate injury" entailed by an unlawful invasion of legal rights.

Similarly, Alcan is mistaken when it asserts that "if Respondent has no standing, this Court has effectively decided the foreign commerce issue." Alcan Brf., at 17. The constitutionality of California's method of taxation does not depend on whether the parent companies are directly injured; it depends on whether *any* burdens imposed by that method of taxation are such as to interfere with the power of Congress to regulate foreign commerce.

B. All of the alleged injuries to the parent companies result from actions taken against the subsidiaries; thus, without more, the injuries are clearly "derivative"

It should be beyond dispute that all of the alleged injuries to the parent companies result from the actions taken against their domestic subsidiaries and therefore are "indirect" or "derivative," at least in that sense.

California has not imposed any taxes on either Alcan or Imperial and has no intention of doing so. If California's method of taxing their domestic subsidiaries results in double taxation of income "earned" by the parent companies or their foreign subsidiaries, this alleged double taxation arises from actions taken against the domestic subsidiaries, namely, from the inclusion in the measure of their subsidiaries' California tax liability of income also taxed elsewhere. Similarly, California has made no informational demands on either Alcan or Imperial and has no intention of doing so. Such demands have been directed only to the domestic subsidiaries. Thus, to the extent that the parent companies have assumed any compliance burdens, they have done so as volunteers, presumably in order to protect the value of their investments. See *EMI Ltd. v. Bennett*, 739 F. 2d 994, 996 (9th

Cir. 1984), cert. den., 469 U.S. 1073 (1984). These burdens are not only incidental to the demands made on the subsidiaries; they are self-imposed.

The derivative nature of the injuries alleged by respondents can be illustrated by a simple hypothetical. Suppose that California made the mistake of including the worldwide income of a totally unrelated foreign corporation in the formula for calculating the California taxes of Alcan's domestic subsidiary, Alcancorp. On the assumption that the worldwide income of the unrelated foreign corporation had been fully taxed by its home country, and that California were to ask Alcancorp for detailed information as to that foreign corporation's business activities, would the unrelated foreign corporation be injured in such a way as to give it standing to challenge the California taxes? Of course not; it could sit on the sidelines, do absolutely nothing about Alcancorp's California taxes, and never be affected by California's actions.

Clearly, Alcan and Imperial are in a different position than the unrelated corporation in the above hypothetical. However, as the hypothetical illustrates, it is not the inclusion of their income in the California formula or California's request for information about their business activities that causes any injury to the parent companies; it is their links as shareholders to their California taxpayer-subsidiaries. Under the stockholder standing rule, such shareholder links cannot form a bridge to establish standing. Thus, requisite standing is lacking on the asserted grounds of double taxation and excessive compliance burdens unless there is some reason for deviating from the rule.

Imperial asserts that double taxation also occurs when a foreign parent company is denied a tax credit by its domiciliary country with respect to dividend payments made by its domestic subsidiary. But again this double taxation, if it occurs at all, results indirectly from the inclusion in the measure of the subsidiary's California tax liability of income which is considered (under the separate accounting approach) to be earned elsewhere. Furthermore, the record establishes that the alleged dividend "injury" to Imperial simply does not exist. Exhibit 19 to the Joint Stipulation of Facts in the Imperial case establishes that no dividends have been paid by Imperial's domestic subsidiary during any of the

years in question and "no occasion" for a claim by Imperial for such a credit "has therefore yet arisen. . . ." Exh. 19, at 5. Imperial rests its claim of injury on an opinion of "what the attitude of the Commissioners would be to a claim for such credit in relation to California franchise tax paid by ICI Americas Inc [sic] in the years in question, *when and if* dividends are declared." Id., at 5-6; emphasis added. As this Court has made clear with respect to the "injury in fact" requirement of Article III, allegations of economic harm sufficient to demonstrate such an injury must be distinct and palpable; they cannot rest on "hypothetical assumptions." *Asarco, Inc. v. Kadish, supra*, 109 S. Ct., 2043.[7]

As for the alleged burden on the parent companies' decision-making, it is highly questionable whether this is a cognizable injury at all (see below). But assuming that such a burden is a cognizable injury, it too results from actions taken against the domestic subsidiaries, not against the parent companies. If California burdens the decision-making of the foreign parents, plainly it is because of the manner in which California calculates the subsidiaries' taxable income.

Without more, then, it is clear that all of the alleged injuries are "derivative" in character. In addition, the fact that the parent companies may suffer different injuries than the subsidiaries is not decisive in determining whether the parent companies have "direct" injuries for standing purposes, or instead are resting their claims on the legal rights of their subsidiaries. A stockholder seeking to challenge actions taken against the corporation in which he holds an interest may proceed against the alleged wrongdoer only upon a showing that he has distinct legal rights at stake. The Board will address that issue in the context of the present case, see *infra*, at 18-20, after first considering in greater detail the alleged burden on the parent companies' decision-making.

[7] Imperial clearly exaggerates the situation when it claims that because it can never obtain a U.K. credit for the California taxes assessed and collected for the three loss years of Americas (1972, 1973, and 1975), this illustrates "economic double taxation in its purest form." Imperial Brf., at 15-16. Dividends can never be paid out of the earnings of the subsidiary in 1972, 1973, or 1975 since, according to its own books of account, Americas realized losses in those years. It follows that double taxation will never result from the denial of a U.K. credit with respect to the three reported loss years since the U.K. would never tax non-existent dividends in the first place.

C. The alleged burden on the parent companies' decision-making is not a cognizable injury, whether it be considered direct or indirect

The Court of Appeals held that California's method of taxation burdens the decision-making of foreign companies by tending to "penalize foreign ownership of American assets." Pet. App., at A15. The court appeared to reach this conclusion on the basis that if foreign companies conduct their commerce through domestic subsidiaries, the overall tax burden will be potentially *greater* than if the companies were to conduct precisely the same foreign commerce through arm's length contracts with unaffiliated companies. *Id.*, at A15-16. Indeed, the Court of Appeals' holding makes absolutely no sense unless it was under the mistaken impression that a tax liability would be incurred if the foreign companies conducted commerce through unaffiliated companies, but that any liability so incurred would be determined under the separate accounting/arm's length approach. This suggests yet another reason why state tax cases initially should be tried in the state courts, which are more familiar with the workings of state tax law.

To repeat what the Board has pointed out earlier: If foreign companies were to conduct their foreign commerce in California through independent contractors, it is unlikely that any tax liability would be incurred in connection with the unitary businesses headed by the foreign companies.[8] It would be preposterous to say that there is a burden on a foreign company's decision-making when it is put to the choice of either (1) doing business in

[8] Furthermore, in the unlikely event that some tax liability would be incurred, that liability would be determined under the unitary business/formula apportionment method of accounting, not the separate accounting/arm's length approach. See Brief for the Petitioners, at 27-29.

a state directly through branch operations or indirectly through a subsidiary, thereby making some component of its unitary business amenable to state taxation, or (2) not doing business in the state, thereby insulating any portion of the unitary business from state taxation. In short, California's tax "penalizes" a foreign company for conducting its commerce through a domestic subsidiary only in the sense that such a subsidiary, by conducting business activities within the state, would necessarily become amenable to taxation. It is not California's method of taxation that "penalizes" the ownership of a domestic subsidiary doing business in California, but *any* tax imposed on that subsidiary.

Alcan appears to be as confused as the Court of Appeals. It argues that California's method of taxation has "effectively deprived foreign parents of the tax benefits of operating in commerce through the vehicles of subsidiaries" as opposed to operating directly in the United States. Alcan Brf., at 14-15. Alcan further states:

> "It was the expectation of Respondent when it invested in the United States that if it entered the United States through a subsidiary, the only impact it would see on its non-U.S. activities would follow exclusively through its shareholder status. Respondent did not expect every activity it conducted outside the United States would influence liability for California income tax." *Id.*, at 9.

What all of this apparently means is that Alcan realized it might be taxed on a unitary basis if it had branch operations in the United States,[9] but it expected to avoid any unitary treatment by setting up a subsidiary. However, Alcan's subsidiary began operations in California some 20 years after the California Supreme Court held in *Edison California Stores v. McColgan*, 30 Cal. 2d 472, 183 P. 2d 16 (1947) that the state's law regarding the formula apportionment of income derived from a unitary business is applicable whether that business is carried on by a single corporation or two or more affiliated corporations. Under these

[9] The use of formula apportionment in this situation was upheld by the Court in *Bass, etc., Ltd. v. Tax Comm.*, 266 U.S. 271 (1924) (United Kingdom corporation with branch operations in New York).

circumstances, Alcan has no basis for complaining that California unexpectedly has denied it the "tax benefits" of conducting commerce through a subsidiary rather than through a branch.[10]

Finally, if California's method of taxation ever constituted a significant burden on the decision-making of foreign companies, that is no longer true. Under a law enacted in 1986, which became effective on January 1, 1988, components of a multinational unitary business may now calculate their tax liabilities under a "water's edge election." See Cal. Rev. & Tax. Code § 25110 et seq.[11] Thus, foreign parent companies hardly are under stress when it comes to deciding whether to conduct their commerce in California through domestic subsidiaries. If they make that choice, *they* can now determine whether foreign factors will be taken into account.[12]

[10] Alcan also claims that its status as the sole stockholder of its domestic subsidiary "is being ignored for the purpose of calculating the California tax," and that having ignored Alcan's stockholder status, the Board "cannot now rely on that status to avoid being challenged for having ignored it in the first instance!" Alcan Brf., at 8-9. California has not ignored the stockholder, i.e., ownership, status of Alcan. A bond of ownership or control is essential to the finding of a unitary business. *Container, supra*, at 166.

[11] Under these circumstances, the note of hysteria that has crept into some of the briefs is uncalled for. See, e.g., Alcan Brf., at 44, n. 22 ("This Court should not be lulled into complacency because actual retaliation has not occurred. International restraint has been exercised because of the recognition of the catastrophic consequence of retaliation and the difficulty of stopping it."); Union Brf., at 9 ("The real danger in California's tax method is that it may cause international trade barriers that took more than forty years to dismantle to be reinstated").

[12] The legality of California's method of taxation for years prior to the enactment of the "water's edge" legislation is at issue in a case currently pending in the California Court of Appeal, *Barclays Bank International Ltd. v. Franchise Tax Board* (3rd Dist., No. C 003388). This case, in which both a foreign parent and its domestic subsidiary are plaintiffs, presents all of the issues relevant to the constitutionality of California's unitary business/formula apportionment method of accounting as applied to a domestic subsidiary of a foreign parent.

D. The parent companies do not hold legal rights distinct from those of their domestic subsidiaries

Respondents argue that they hold legal rights distinct from those of their domestic subsidiaries because, as Imperial puts it, the subsidiaries, unlike their parent companies, are "not within the class of foreign investors protected by federal foreign commerce policy." Imperial Brf., at 24. In other words, respondents persist in taking the position that their domestic subsidiaries cannot raise claims under the Foreign Commerce Clause because they are not engaged in foreign commerce. The Court of Appeals aptly characterized this theory as "idiosyncratic." Pet. App., at A4, n. 4. Respondents insist that California's method of calculating the taxable income of their domestic subsidiaries is subject to contraints imposed by the Foreign Commerce Clause because the domestic subsidiaries constitute "instrumentalities of foreign commerce." They cannot be heard to argue at the same time that the subsidiaries are not engaged in foreign commerce and hence may not claim protections under the Foreign Commerce Clause.

Although the Court of Appeals rejected respondents' "idiosyncratic" theory, it proceeded to determine, in effect, that the foreign parent companies hold legal rights distinct from those of their subsidiaries because "the subsidiaries are owned as instrumentalities of the foreign commerce of their parents." Pet. App., at A15. In the court's view, the parent companies have distinct legal rights as the owners of these instrumentalities of commerce and thus are not injured solely in their capacity as corporate stockholders. But surely the mere fact that the subsidiaries may be owned as instrumentalities of foreign commerce cannot mean that the parent companies have standing to complain of any actions which are taken against the subsidiaries and hence burden the conduct of the parents' foreign commerce. As the Board previously has pointed out, every wholly-owned subsidiary can be viewed as an instrumentality by which its parent company conducts one type of commerce or another. If the ownership of a subsidiary as an instrumentality of commerce were deemed sufficient to create an exception to the traditional standing rule prohibiting individual actions by corporate stockholders, the exception would swallow the rule.

Respondents assert that there is no danger of the exception swallowing the rule—and hence that the concerns expressed by the Board's amici are unfounded—because, as Imperial states, "It is impossible to conceive of another set of facts or a taxing regime other than the Board's application of California's unitary method that would, in combination, permit an action of this nature in federal court." Imperial Brf., at 28; see also Alcan Brf., at 48-49. According to Imperial, the decision of the Court of Appeals deals only with the standing of a *foreign* parent and sets forth three elements which must be present for standing to exist: (1) an area of recognized federal supremacy; (2) the absence of an affirmative policy permitting state intrusion in the area of concern; and (3) the lack of any remedy for the parent in the state courts. Imperial Brf., at 29. The Court of Appeals did not spell out these conditions. Furthermore, even if the conditions can fairly be implied from the Court of Appeals' holding on the standing issue, they are as applicable to the broad range of tax matters involving interstate commerce as to the particular Foreign Commerce Clause issues presented by the unitary tax system.[13] Finally, if the Court of Appeals' rationale is to be limited to *foreign* parent

---

[13] The Court of Appeals' holding that a burden on the decision-making of a parent company is a sufficient "injury" for standing purposes would also be applicable in cases involving neither foreign commerce nor the unitary method of taxation. Assume, for example, that a state were to adopt a sales tax reporting system which, while only based on sales made within that state, was different from all other states' systems. A U.S. corporation which chose to make sales in that state through a subsidiary would be required to incur the expense of developing new expertise in its tax compliance staff, an expense that could be avoided if the parent company sold its goods in the state through an independent contractor. Under the Court of Appeals' reasoning, the burden upon the commerce decisions of the parent corporation, particularly if the states' sales tax system allegedly discriminated against the type of business conducted by the corporation, would constitute an "injury" giving the out-of-state nontaxpayer corporation standing to challenge the constitutionality of that state's sales tax statute.

companies, the latter inexplicably are given an advantage not possessed by parent companies organized in the United States.[14]

Also perplexing is respondents' underlying thesis that, while they are foreign corporations doing business exclusively outside the United States, they hold rights under the Commerce Clause that are not only distinct from, but more expansive than, the rights held by the subsidiary companies that are organized under the laws of this country. Aside from the anomaly, it is clear that the Commerce Clause is not the source of "individual" rights as such, see *Exxon Corp. v. Governor of Maryland*, 437 U.S. 117, 127-128 (1978), and therefore the foreign parents do not have rights under the Commerce Clause that are peculiar to them. Thus, any constitutional objections the parent companies may have to California's method of taxation are shared with the taxpayer-subsidiaries. Stated another way, the parent companies, at the most, have a "right" to engage in foreign commerce in the United States through subsidiaries without those subsidiaries being subjected to a tax which violates the Foreign Commerce Clause. The interests of the subsidiaries as the "instrumentalities of the foreign commerce of their parents" are the same.

---

[14] One of the amici for respondents states that the very denial of standing in this case "places an added burden on international commerce that a domestic parent does not have to face, because a domestic parent will always have standing, as the nominal taxpayer, in some American court." Shell Brf., at 15. This is incorrect for the simple reason that a domestic parent is not always what is termed the "nominal" taxpayer. The taxpayer is the entity subject to California taxes. When that entity is a subsidiary of a parent company which does business exclusively outside the state, the subsidiary is the only "nominal" taxpayer. See, e.g., *Edison California Stores v. McColgan*, 30 Cal. 2d 472, 183 P. 2d 16 (1947); *Chase Brass & Copper Co. v. Franchise Tax Board*, 10 Cal. App. 3d 496, 95 Cal. Rptr. 805 (1970), cert. den., 400 U.S. 961 (1970). Thus, the parent company in such a case could not challenge a tax assessment against the subsidiary in the California courts. It would also be precluded from challenging the assessment in the federal courts or in the courts of any other state—or at least that was the general understanding prior to the issuance of the decision under review.

III

EVEN IF THE PARENT COMPANIES CAN BE VIEWED AS SUFFERING DIRECT INJURIES AS A RESULT OF CALIFORNIA'S METHOD OF TAXING THEIR DOMESTIC SUBSIDIARIES, THE PARENT COMPANIES SHOULD BE REQUIRED TO PURSUE THEIR CONSTITUTIONAL OBJECTIONS THROUGH THE STATE REMEDIES EFFECTIVELY AVAILABLE TO THEM

A. Respondents and their amici have not advanced any plausible basis for their assertion that the available state remedies are inadequate

The Tax Injunction Act (28 U.S.C. § 1341) prohibits the district courts from intervening in state tax matters "where a plain, speedy and efficient remedy may be had in the courts of such State." The Board's argument in this case is that respondents effectively have such remedies due to their total control over the pursuit of state remedies by the taxpayer-subsidiaries. In essence, the principal counter-arguments of respondents and their amici run as follows: (1) the domestic subsidiaries cannot challenge the tax assessments on Foreign Commerce Clause grounds because they are not engaged in foreign commerce; (2) assuming that the domestic subsidiaries can claim protections under the Foreign Commerce Clause, they are not in a position to complain of the burdens allegedly imposed on their parent companies, or at least whether they can do so is entirely speculative; and (3) in any event, if the parent companies suffer direct injuries, they are entitled to their own day in court.

The assertion that the domestic subsidiaries cannot raise claims under the Foreign Commerce Clause because they are not engaged in foreign commerce is illogical in view of the respondents' basic premise that the subsidiaries constitute "instrumentalities of foreign commerce." See, *supra*, at 18. The assertion is also illogical for another reason. To say that a taxpayer is powerless to raise constitutional objections to a tax which *it* is required to pay is tantamount to saying that a taxpayer must abide by a tax assessment even though it is constitutionally invalid. Very simply, this makes no sense.

Nor does it make sense to assert that the subsidiaries in the present matter cannot complain of any burdens on the conduct of foreign commerce which may be considered to fall directly on the parent companies. Imperial, for example, states that if, as the Board contends, a shareholder has no standing to litigate claims based on injury to the corporation, "it follows with equal or greater force that a corporation has no standing to raise claims based on injury to its shareholders." Imperial Brf., at 25-26. That may be true where actions against a shareholder do not directly injure the corporation. But just as a stockholder can complain of actions against a corporation which directly injure the stockholder, it should be clear that a corporation can complain of actions against a stockholder which directly injure the corporation. Beyond question, a corporate taxpayer is directly injured by an assessment of taxes in addition to those reported as due. It necessarily follows that legal rights of respondents' subsidiaries are at stake here. Furthermore, any injury to the parent companies in the present case raises precisely the same legal issue as the injury to their subsidiaries: Does California's method of calculating the taxable income of the subsidiaries interfere with Congress' power to regulate foreign commerce?

It is nonetheless asserted that whether a state court would permit the domestic subsidiaries to complain of the burdens imposed on their parent companies is entirely "speculative" and that "A speculative remedy is not a plain, speedy and efficient remedy within the meaning of the [Tax Injunction] Act." Brief of the Committee of London and Scottish Bankers ("Bankers Brf."), at 4. Actually, however, it is respondents who are asking this Court to engage in unwarranted speculation: that a state court will not apply constitutional principles as enunciated by this Court. In *Japan Line, Ltd. v. Los Angeles County*, 441 U.S. 434 (1979), the Court held that when a state seeks to tax instrumentalities of foreign commerce, two additional considerations, beyond those articulated in *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274 (1977),[15] come into play: "the enhanced risk of

[15] The Court held in *Complete Auto Transit* that a state tax will survive challenge under the Interstate Commerce Clause if the tax "[1] is applied to an activity with a substantial nexus with the taxing State,

multiple taxation" and the possibility that such a tax may "impair federal uniformity in an area where federal uniformity is essential." 441 U.S., at 446, 448. In *Container*, the Court held that this additional scrutiny is required when a state tax case involves a unitary business that is international in scope. 463 U.S., at 185. It cannot be presumed that, when confronted with a tax case involving a multinational enterprise, a state court will decline to follow the mandate of this Court and refuse to consider the issues raised by the Foreign Commerce Clause, i.e., whether the disputed tax creates an impermissible risk of double taxation or violates the "one voice" standard.[16]

For Alcan to make such a claim is particularly inappropriate. Currently pending in the California courts are two suits for refund filed by Alcan's wholly-owned subsidiary, one of which dates back to 1977. Alcan Stip., ¶ 36, Exh. XIX-1 and 2. Rather than having its subsidiary pursue those actions—and thus putting to a test its theory that the subsidiaries cannot raise claims under the Foreign Commerce Clause, Alcan has permitted the actions to languish in the state courts while it has gone from one circuit to another in search of a receptive federal forum.[17] Apropos here is the follow-

[2] is fairly apportioned, [3] does not discriminate against interstate commerce, and [4] is fairly related to the services provided by the State." 430 U.S., at 279.

[16] As previously pointed out, see *supra*, at n. 12, both of these issues are under consideration in *Barclays Bank International Ltd. v. Franchise Tax Board* (3rd Dist. No. C 003388), which is currently pending in the California Court of Appeal.

[17] Alcan audaciously claims that, despite the fact that Alcan filed this action in the Seventh Circuit after the Second Circuit rejected Alcan's claim of standing in *Alcan Aluminum Ltd. v. Franchise Tax Board*, 558 F. Supp. 624 (S.D.N.Y. 1983), aff'd mem., 742 F. 2d 1430 (2d Cir. 1983), cert. den., 464 U.S. 1041 (1984), the charge of "forum shopping" by one of the Board's amici "is not supported by the facts." Alcan Brf., at 49, n. 25. What except "forum shopping" explains the Illinois situs of the second suit? It is also to be noted that there appears to be no other explanation for the filing of Imperial's action in Illinois. Logically the action would have been filed either in California or New York, where the Board's audit of the domestic subsidiary was conducted.

ing statement in *Pennzoil Co. v. Texaco, Inc.*, 481 U.S. 1, 15 (1987), where the complaining party asserted that the Texas courts would not entertain its constitutional claims:

> "[D]enigations of the procedural protections afforded by Texas law hardly come from Texaco with good grace, as it apparently made no effort under Texas law to secure the relief sought in this case. (Citation omitted.) Article VI of the United States Constitution declares that 'the Judges in every State shall be bound' by the Federal Constitution, law, and treaties. We cannot assume that state judges will interpret ambiguities in state procedural law to bar presentation of federal claims. (Citation omitted.) Accordingly, when a litigant has not attempted to present his federal claims in related state-court proceedings, a federal court should assume that state procedures will afford an adequate remedy, in the absence of unambiguous authority to the contrary."

In this case, unlike *Pennzoil*, the complaining parties do not have direct remedies in the state courts for airing their grievances. However, the taxpayer-subsidiaries have access to the state courts to air the *same* grievances. The parent companies, as the sole stockholders of the domestic subsidiaries, have full control over the pursuit of state remedies by the actual taxpayers. It therefore defies reason to contend, as do respondents, that the parent companies effectively have no remedies in the state courts. Cf., *South Carolina v. Regan*, 465 U.S. 367, 381, n. 19 (1984).[18] Any

JA 43. Both the Ninth and Second Circuits, however, had already ruled that foreign parent companies lack requisite standing to challenge taxes imposed on their domestic subsidiaries.

[18] The assertion that the *South Carolina* case supports respondents' position, rather than the Board's, completely ignores the reasoning of the decision. The Court pointed out that if the aggrieved party in that case were denied injunctive relief, it "would be required to depend on the mere possibility of persuading a third party to assert [its] claims." 465 U.S., at 381. A parent company does not have to exercise any powers of persuasion over a wholly-owned subsidiary.

One amicus also suggests that the *South Carolina* case is distinguishable because "the Tax Injunction Act [does] not contain the third party prohibition of the Anti-Injunction Act." Bankers Brf., at 14. While this

claim that the parent companies are better equipped than their subsidiaries to litigate the constitutional issues is also at odds with reality. The subsidiaries, through their house counsel, have represented the parent companies at every stage of the federal litigation. They are as prepared to litigate the constitutional issues as the parent companies choose to make them. Is it really asking too much to require that the battle be waged by the subsidiaries in the state courts, where the controversy rightfully belongs?

In answering that rhetorical question, the parent companies would insist that they are entitled to their own day in court. Under the circumstances of the present case, however, where the parent companies exercise total control over the subsidiaries' pursuit of state remedies, and where the state courts presumably would consider all of the Foreign Commerce Clause objections to California's tax, the insistence has a hollow ring. Cf., *Schenley Corp. v. United States*, 326 U.S. 432, 435 (1946). It amounts to little more than a claim that the parent companies are entitled to bring an action in their own names in the federal courts, rather than have the subsidiaries pursue actions in *their* names in the state courts. If the Tax Injunction Act's proscriptions hinge on that sort of technicality, its days obviously are numbered.

B. The entertainment of such actions by the federal courts would frustrate the policies underlying the Tax Injunction Act

Imperial asserts that its action in the federal courts should not be barred by the Tax Injunction Act, or by principles of federal abstention and comity, because the action "do[es] not create a risk of interference with *normal* State collection procedures." Imperial Brf., at 8; emphasis added. By way of explanation, Imperial points out that "There is no interference with California's audit and collection process vis-a-vis the income of the U.S. subsidiary, Americas, as determined under federal law and inter-

is true, the Court recognized in *Bob Jones University v. Simon*, 416 U.S. 725, 731-732, n. 6 1974 that the phrase in the Anti-Injunction Act dealing with third-party standing was "a reaffirmation of the plain meaning of . . . § 7421(a)" as it existed prior to the addition of the phrase. See also *South Carolina*, at 377-378, n. 16.

national practice." *Id.*, at 29. In other words, in Imperial's view, the policies expressed in the Tax Injunction Act apply only when the state is attempting to collect taxes which are conceded to be due (in this case, under the separate accounting/arm's length method of accounting). Upon further reflection, surely even Imperial would agree that this is carrying things a bit too far.

In keeping with the suggestion of the Court of Appeals, it is further urged that California has at its disposal a ready solution to federal intrusion in its tax matters: simply grant a remedy to the foreign parents. One amicus asks, "Why would the pressing of its suit by the litigant which has a direct injury be more disruptive to the state, particularly if the constitutional claims are, as the state contends, the same?" Bankers Brf., at 16. As the representatives of that particular amicus are well aware, Article XIII, section 32 of the California Constitution provides:

> "No legal or equitable process shall issue in any proceeding in any court against this State or any officer thereof to prevent or enjoin the collection of any tax. After payment of a tax claimed to be illegal, an action may be maintained to recover the tax paid, with interest, in such manner as may be provided by the Legislature."

The policy behind this provision is the same as the policy underlying the Tax Injunction Act: "to allow revenue collection to continue during litigation so that essential public services dependent on the funds are not unnecessarily interrupted." *Pacific Gas & Electric Co. v. State Bd. of Equalization*, 27 Cal. 3d 277, 283, 165 Cal. Rptr. 122, 611 P. 2d 463 (1980). The notion that California could easily, and with good conscience, amend its Constitution to provide special equitable remedies for foreign parent companies which object to the manner in which California taxes their domestic subsidiaries is absurd.[19]

---

[19] The following statement of Alcan falls into the same category, and is offensive as well:

> "Nor was Petitioners' failure to give Respondent a remedy an oversight. When questioned, Petitioners made it quite clear that they would never grant Respondent a remedy because in their view the tax imposed no foreign commerce burden." Alcan Brf., at 46.

A final point to be considered is the role which "international comity" plays in this case. Respondents and their amici argue in substance that the Tax Injunction Act and its underlying principle of comity should give way when a state tax has foreign repercussions. It is said that such circumstances "shift" the policy considerations "from those of 'our federalism,' which concerns balance between our states and our national government, to those of 'our nation' and its dealings with other nations." Bankers Brf., at 19. This argument insinuates that the federal policies expressed in the Tax Injunction Act conflict with the goals of "our nation" in foreign affairs. In other words, it attempts to give a new twist to the "one voice" standard. The problem with the argument, however, is that the prohibition against injunctive relief in state tax matters does not raise a conflict between state and federal policies in an area of international affairs, where the voice of the federal government is supreme. The Tax Injunction Act is a *federal* statute limiting *federal* jurisdiction over state tax matters, and the policies it reflects are policies of the *federal* government.

Furthermore, the suggestion that concerns of "our federalism" and concerns of "our nation" are polarized is incorrect. Frequently when "our nation" speaks in the area of foreign affairs it voices principles of "our federalism." That is illustrated by some of the historical facts which bear on the constitutional merits of respondents' claims. For example, as this Court observed in *Container, supra*, at 196, "the tax treaties into which the United States has entered do not generally cover the taxing activities of subnational governmental units such as States, and in none of the treaties does the restriction on 'non-arm's length' methods of taxation apply to the States." To the extent the treaties are not intended to restrict the taxing powers of the states, they reflect federalism concerns.[20]

Understandably, Alcan cites no authority for this accusation, either in the record or otherwise.

[20] In *Wardair Canada v. Florida Dept. of Revenue*, 477 U.S. 1 (1986), a case which involved a tax on fuel used by foreign airlines solely in foreign commerce, this Court held that,

> "By negative implication arising out of more than 70 agreements entered into since the Chicago Convention [on International Civil

It is further urged that, in any event, foreign nations can rightfully expect that their corporations will be given access to some judicial forum within the United States in which they can complain of state taxes levied against their subsidiaries. See, e.g., Alcan Brf., at 48; Brief of the Committee on State Taxation of the Council of State Chambers of Commerce, at 3-4, 7. On the contrary, foreign nations cannot properly harbor that expectation unless corporations domestic to the United States have similar access to the courts to complain of state taxes levied against *their* subsidiaries. At best, foreign nations are entitled to *national* treatment with respect to access to the courts;[21] they are not entitled to preferential treatment.

Aviation], the United States has at least acquiesced in state taxation of fuel used by foreign carriers in international travel. Again, in the U.S.-Canadian Agreement only 'national' charges are barred, and we presume that drafters from two federalist nations understood this as representing a choice not to preclude local taxation." 477 U.S., at 12.

Not surprisingly, one of the major questions raised by the controversy over California's use of formula apportionment to calculate the taxable income of a domestic subsidiary of a foreign parent is whether the nonapplicability to the states of the treaty provisions requiring the use of separate accounting represents "an omission which must be understood as representing a policy choice [of the federal government]." *Id.*, at 11.

[21] See, e.g., Article V, ¶ 1, Treaty of Friendship, Commerce and Navigation between the United States of America and the Kingdom of The Netherlands, March 27, 1956, reproduced in Shell Brf., at A-1.

CONCLUSION

The Court of Appeals, both at the expense of the stockholder standing rule and at the expense of the Tax Injunction Act and its underlying principle of comity, held in this case that foreign companies have standing in the federal courts to challenge the constitutionality of the manner in which a state determines the taxable income of their domestic subsidiaries. The decision is wrong and should be reversed.

DATED: August 9, 1989

Respectfully submitted,

JOHN K. VAN DE KAMP,
Attorney General of the State of California
TIMOTHY G. LADDISH
Assistant Attorney General
(Counsel of Record)
Attorneys for Petitioners

Of Counsel:
PATRICIA STRELOFF, ESQ.
3436 Springhill Road
Lafayette, CA 94549